

CILCO EXHIBIT 2.0

OFFICIAL FILE

U.S. G. O. DOC. NO. 01-0785/0792

CILCO 2.0

DATE 1-18-02 BY CB

ILLINOIS COMMERCE COMMISSION

DOCKET 01-__

PREPARED JOINT DIRECT TESTIMONY OF

BRENDA FREEMAN AND TOM BRAMSCHREIBER

1 Q1: Please state your names and business addresses.

2 A1: Brenda Freeman and my business address is 300 Liberty Street, Peoria, Illinois
3 61602.

4 Tom Bramschreiber and my business address is 1901 Butterfield Road, Suite 650,
5 Downers Grove, Illinois 60515.

6 Q2: Ms. Freeman, by whom are you employed and in what position?

7 A2: I am presently employed as a Finance Team Member on the Finance and
8 Administration Team of Central Illinois Light Company ("CILCO").

9 Q3: Mr. Bramschreiber, by whom are you employed and in what position.

10 A3: I am presently employed as a Project Director with AES Great Plains Inc., the
11 business unit of AES where CILCO resides.

12 Q4: Ms. Freeman, please describe your educational background and business
13 experience.

14 A4: I hold a Bachelor of Science degree in Accounting and a Masters of Business
15 Administration degree from Bradley University. I have been employed by
16 CILCO since 1991. My work experience at CILCO includes positions in
17 accounting, tax, treasury, and investments and finance. I have worked on the
18 Finance and Administration Team since 1999.

19 Q5: Mr. Bramschreiber, please describe your educational background and business
20 experience.

21 A5: I hold a Bachelor of Science degree in Finance from Bowling Green State
22 University and a Masters of Business Administration degree in Finance from
23 DePaul University. I have been employed by AES, in various business units,
24 since 1999. From 1994 to 1998, I was employed by MidCon Corp., a subsidiary
25 of Occidental Petroleum and later KN Energy, where I held various positions in
26 retail and wholesale energy marketing, supply procurement, and product
27 development and planning. From 1984 to 1994, I was employed by The Peoples
28 Gas, Light & Coke Company, a subsidiary of Peoples Energy, in various gas
29 supply planning and regulatory affairs positions.

30 Q6: In addition to your joint direct testimony, CILCO Appendix N, are you
31 sponsoring any other exhibits?

32 A6: Yes, we are sponsoring the following five exhibits, which were prepared under
33 our direction and control: CILCO Appendix N-2 (Treasury Bond Yields and
34 CILCO Historical Returns), CILCO Appendix N-3 (Financial Projections Under
35 A No Customer Switching Scenario), CILCO Appendix N-4 (Financial
36 Projections Under A Customer Switching Scenario - - As Filed Delivery Services
37 Rates), CILCO Appendix N-5 (Financial Projections Under A Customer
38 Switching Scenario - - Existing Delivery Services Rates), and CILCO Appendix
39 N-6 (Financial Projections Under A Customer Hyper-Switching Scenario - -
40 Existing Delivery Services Rates).

41

41 Q7: What is the purpose of your joint direct testimony in this proceeding?

42 A7: The purpose of our joint direct testimony is to present projections of CILCO's
43 earned rates of return on common equity ("ROE"), for the years 2002 through
44 2004, calculated in accordance with Section 16-111(d) of the Illinois Public
45 Utilities Act ("Act"). As required by Section 16-111(g)(vi) of the Act, we will
46 demonstrate that CILCO's earned rate of return on common equity, as a result of
47 the transfer of CILCO's generation assets to Central Illinois Generation, Inc.
48 ("CIGI"), a wholly owned non-utility subsidiary of CILCO, will not produce a
49 strong likelihood of the need for a rate increase under Section 16-111(d) of the
50 Act.

51 Q8: Please describe the requirements for an electric base rate increase under Section
52 16-111(d) of the Act.

53 A8: It is our understanding that Section 16-111(d) of the Act permits an electric utility
54 to request an increase in its base rates during the mandatory transition period,
55 which extends through 2004, if its two-year average return on common equity
56 falls below the average return on 30-year U.S. Treasury bonds for the same two
57 year period. The calculation of earned rate of return on common equity specified
58 in Section 16-111(d) states:

59 an electric utility may request an increase in its base rates if the
60 electric utility demonstrates that the 2-year average of its earned rate of
61 return on common equity, calculated as its net income applicable to
62 common stock divided by the average of its beginning and ending
63 balances of common equity using data reported in the electric utility's
64 Form 1 report to the Federal Energy Regulatory Commission but adjusted
65 to remove the effects of accelerated depreciation or amortization or other
66 transition or mitigation measures implemented by the electric utility
67 pursuant to subsection (g) of this Section, is below the 2-year average for
68 the same 2 years of the monthly average yields of 30-year U.S. Treasury

bonds published by the Board of Governors of the Federal Reserve System in its weekly H.15 Statistical Release or successor publication.

This is a historical calculation of the two-year average earned ROE as reported in the electric utility's Form 1 report to the Federal Energy Regulatory Commission ("FERC") and compared to the historical yields of 30-year U.S. Treasury bonds over the same two-year period.

Q9: Please describe the operational and financial projection requirements under Section 16-111(g)(vi) of the Act.

A9: It is our understanding that CILCO must show that the proposed transfer of generation assets under Section 16-111(g)(vi) of the Act (i) will not render the electric utility unable to provide its tariffed services in a safe and reliable manner, and (ii) that there is not a strong likelihood that consummation of the proposed transaction will result in the electric utility being entitled to request an increase in its electric base rates during the mandatory transition period pursuant to Section 16-111(d).

CILCO witness Robert Sprowls and Robert G. Ferlmann address the former requirement. With respect to the latter requirement, we have prepared projections of CILCO's two-year average returns on common equity through 2004, both with and without the proposed transfer, assuming no retail load loss to alternative generation providers ("No Customer Switching"). The results, when compared to projected average monthly yields of 30-year U.S. Treasury bonds, indicate that there is not a strong likelihood of the utility qualifying to request an increase in electric base rates during the mandatory transition period. In addition, although we believe the level of customer switching that may occur is not a

94 function of whether or not the generation assets are transferred, we have prepared
95 various projections of CILCO's two-year average returns on common equity
96 through 2004, both with and without the proposed transfer, assuming an
97 increasing level of annual retail load loss to alternative generation providers
98 ("With Customer Switching"). These results, when compared to projected
99 average monthly yields of 30-year U.S. Treasury bonds, also indicate that there is
100 not a strong likelihood of the utility qualifying to request an increase in electric
101 base rates during the mandatory transition period.

102 Q10: What were the average monthly yields of 30-year U.S. Treasury bonds for the
103 most recent two calendar years?

104 A10: The average monthly yields of 30-year U.S. Treasury bonds for the twenty-four
105 month period ending December 31, 2000, was 5.90%. This data is shown on Page
106 1 of CILCO Appendix N-2.

107 Q11: What are the projected average monthly yields of 30-year U.S. Treasury bonds
108 which CILCO compared its financial projections?

109 A11: For conservative comparison purposes, CILCO relied on the current spot yield for
110 30-year U.S. Treasury bonds and the historical variability of bond yields. The
111 spot yield for 30-year U.S. Treasury bonds on November 15, 2001, was 5.22%.
112 To estimate historical variability of bond yields, CILCO calculated the standard
113 deviation of two-year average monthly returns over the last decade to be 0.84%.
114 The standard deviation is a statistical measure of how widely values are dispersed
115 from the average value or mean.

116 Adding two statistical standard deviations, or 168 basis points, to the
117 current spot bond yield of 5.22% produces a probability of approximately 95%
118 that 30-year U.S. Treasury bond yields will be no higher than 6.90%. For
119 conservative comparison purposes, CILCO has assumed 6.90% to be the
120 projected average annual monthly yield of 30-year U.S. Treasury bonds. This
121 data is shown on Page 2 of CILCO Appendix N-2. Treasury bond yields
122 approaching such levels have not occurred since 1997.

123 Q12: What have CILCO's historical two-year average earned rates of return on
124 common equity been?

125 A12: As reported in CILCO's FERC Form 1 report, the unadjusted two-year average
126 rates of return on common equity have ranged from 8.74% to 14.14% over the last
127 decade. The unadjusted two-year average return on common equity has exceeded
128 the two-year average 30-year U.S. Treasury bond yield by a minimum of 300
129 basis points in every corresponding period, with an average difference of almost
130 500 basis points. The positive correlation between CILCO's earned rate of return
131 on common equity and 30-year U.S. Treasury bond yields is shown on Page 3 of
132 CILCO Appendix N-2.

133 Q13: What assumptions were used in developing CILCO's projected rate of return on
134 common equity assuming no retail load loss to alternative generation providers?

135 A13: The key No Customer Switching assumptions which underlie the financial
136 projections are set forth on Pages 1 - 3 of CILCO Appendix N-3.

137 Q14: What are the results of the comparison of the projected earned rates of return on
138 common equity to the projected Treasury bond yields assuming no retail load loss
139 to alternative generation providers?

140 A14: As shown on Page 8 of CILCO Appendix N-3, the projected earned rates of return
141 on common equity through the mandatory transition period indicate that the
142 transfer of generation assets will not affect CILCO's returns such that there is a
143 strong likelihood that CILCO would be entitled to seek an increase in its electric
144 base rates. In both No Customer Switching scenarios, the projected earned rates
145 of return on common equity are well above the projected average annual monthly
146 yields of 30-year U.S. Treasury bonds. This is shown on Page 4 of CILCO
147 Appendix N-3, which assumes no transfer of generation assets, and on Page 8 of
148 CILCO Appendix N-3, which assumes the transfer of generation assets.

149 Q15: What assumptions were used in developing CILCO's projected rate of return on
150 common equity assuming retail load loss to alternative generation providers?

151 A15: The key With Customer Switching assumptions which underlie the financial
152 projections are set forth on Pages 1 - 3 of CILCO Appendix N-4. To date, CILCO
153 has not experienced any retail load loss to alternative generation providers. For
154 purposes of this filing, however, we have developed financial projections
155 assuming an increasing level of annual retail load loss to alternative generation
156 providers (5% in 2002, 10% in 2003, and 15% in 2004).

157 As previously stated, we believe that the level of customer switching that
158 may occur is not a function of whether or not the generation assets are transferred.
159 As noted on the Illinois Commerce Commission's Website, customers may

160 choose who supplies the generation portion of their electric service for a variety
161 of reasons.

162 Those [reasons] may include how or where the electricity is produced,
163 economic or environmental support, the lowest price or total cost or the
164 best combination of prices, services and incentives.

165
166 None of these reasons are affected or altered by the transfer of generation assets
167 during the mandatory transition period. Commission approved bundled and
168 delivery service rates do not change as a result of the transfer of generation
169 assets. In terms of switching decisions, customers are indifferent to the transfer of
170 generation assets.

171 Moreover, any financial impact to CILCO arising from customer
172 switching, positive or negative, would occur regardless of the transfer of
173 generation assets (i.e., difference between bundled service rates and delivery
174 service rates plus any wholesale revenue from freed-up energy sales). CILCO is
175 proposing to transfer substantially all of its generation assets to CIGI, a wholly
176 owned non-utility subsidiary of CILCO. For purposes of calculating the earned
177 rate of return on common equity under Section 16-111(d) of the Act, the earnings
178 or losses of subsidiary companies are included in FERC Form 1 and are therefore
179 reflected in the earned rate of return on common equity calculation. In essence,
180 the net income and common equity of CILCO, as reported in FERC Form 1, will
181 not be affected by the proposed transfer of generation assets.

182 Q16: What are the results of the comparison of the projected earned returns on common
183 equity to the projected Treasury bond yields assuming an increasing level of
184 annual load loss to alternative generation providers?

185 A16: As shown on Page 8 of CILCO Appendix N-4, the projected earned rates of return
186 on common equity through the mandatory transition period indicate that the
187 transfer of generation assets, even with an increasing level of annual load loss to
188 alternative generation providers, will not affect CILCO's returns such that there is
189 a strong likelihood that CILCO would be entitled to seek an increase in its electric
190 base rates. In both With Customer Switching scenarios, the projected earned rates
191 of return on common equity are well above the projected average annual monthly
192 yields of 30-year U.S. Treasury bonds. This is shown on Page 4 of CILCO
193 Appendix N-4, which assumes no transfer of generation assets, and on Page 8 of
194 CILCO Appendix N-4, which assumes the transfer of generation assets.

195 Q17: Have you developed any other financial projections?

196 A17: Yes. The With Customer Switching financial projections shown in CILCO
197 Exhibit N-4 incorporate delivery services revenues reflective of CILCO's recently
198 filed tariffs in consolidated ICC Docket Nos. 01-0637, 01-0465, and 01-0530
199 ("As Filed Delivery Services Rates"). We have modified CILCO Exhibit N-4 to
200 incorporate delivery services revenues reflective of CILCO's previously approved
201 tariffs in consolidated ICC Docket Nos. 99-0119 and 99-0131 ("Existing Delivery
202 Services Rates"). The financial projections shown in CILCO Exhibit N-5 are
203 reflective of the previously approved delivery services rates.

204 In addition, we have further modified the With Customer Switching
205 financial projections to reflect "hyper-switching". We believe that the level of
206 switching reflected in the With Customer Switching financial projections are
207 aggressive given existing bundled service rates (i.e., 5% in 2002, 10% in 2003,

208 and 15% in 2004). Nonetheless, we have modified CILCO Exhibit N-5 to reflect
209 even further annual loss of retail load to alternative generation providers (i.e.,
210 10% in 2002, 20% in 2003, and 30% in 2004). The financial projections shown in
211 CILCO Exhibit N-6 are reflective of the previously approved delivery services
212 rates and an assumed *doubling* of annual retail load loss to alternative generation
213 providers.

214 Q18: What is your conclusion?

215 A18: Based upon the projected earned rates of return on common equity under the
216 various scenarios described above, the consummation of the proposed transaction
217 will not result in CILCO being entitled to request an increase in its base rates
218 during the mandatory transition period pursuant to Section 16-111(d) of the Act.
219 Even under the most extreme "hyper-switching" scenario, CILCO's projected rate
220 of return on common equity is at least two standard deviations above current 30-
221 year U.S. Treasury bond yields. This indicates that there is not a strong likelihood
222 that CILCO will qualify to request an increase in base rates during the mandatory
223 transition period.

224 Q19: Does this conclude your joint direct testimony?

225 A19: Yes.

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Central Illinois Light Company)
)
Notice of transfer of generation assets to a)
subsidiary and entry into various agreements) Docket No. 01-_____
pursuant to Section 16-111(g) of the Illinois)
Public Utilities Act.)

AFFIDAVIT OF TOM BRAMSCHREIBER

Tom Bramschreiber, being first duly sworn on oath, deposes and states as follows:

1. I prepared and am familiar with the contents of Appendix N to CILCO's Notice of Transfer of Assets, which bears the title "Prepared Joint Direct Testimony of Brenda Freeman and Tom Bramschreiber." My answers to the questions appearing in said appendix are true and correct to the best of my knowledge and belief.
2. CILCO Appendices N-2, N-3, N-4, N-5 and N-6 were prepared under my direction and control and accurately portray what they purport to portray.
3. Further Affiant sayeth naught.

Tom Bramschreiber

Tom Bramschreiber

SUBSCRIBED AND SWORN TO BEFORE ME

THIS 21st DAY OF NOVEMBER, 2001

FRANK P LUCAFO
NOTARY PUBLIC



STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Central Illinois Light Company)
)
Notice of transfer of generation assets to a)
subsidiary and entry into various agreements) Docket No. 01-_____
pursuant to Section 16-111(g) of the Illinois)
Public Utilities Act.)

AFFIDAVIT OF BRENDA FREEMAN

Brenda Freeman, being first duly sworn on oath, deposes and states as follows:

1. I prepared and am familiar with the contents of Appendix N to CILCO's Notice of Transfer of Assets, which bears the title "Prepared Joint Direct Testimony of Brenda Freeman and Tom Bramschreiber." My answers to the questions appearing in said appendix are true and correct to the best of my knowledge and belief.
2. CILCO Appendices N-2, N-3, N-4, N-5 and N-6 were prepared under my direction and control and accurately portray what they purport to portray.
3. Further Affiant sayeth naught.

Brenda Freeman
Brenda Freeman

SUBSCRIBED AND SWORN TO BEFORE ME
THIS 21st DAY OF NOVEMBER, 2001

Dana K. McNeil
NOTARY PUBLIC

